No. 80-1052

IN THE

Supreme Court of the United States

Supreme Court, U. S.
FILED
DEC 23 1980
MICHAEL RODAK, JR., CLERK

.... Term, 1980

WINE & SPIRITS WHOLESALERS OF CALIFORNIA, a California corporation,

Petitioner,

vs.

NORMAN WILLIAMS COMPANY, etc., *et al.*,

Respondents.

Petition for Writ of Certiorari to the Court of Appeal of the State of California, Third Appellate District.

JOSEPH A. BALL,
MICHAEL J. MALONEY,
JAMES POLISH,
Counsel of Record,
BALL, HUNT, HART, BROWN AND BAERWITZ,
445 South Figueroa Street,
33rd Floor.,
Los Angeles, Calif. 90071,
(213) 628-0924,
Attorneys for Petitioner Wine & Spirits Wholesalers of California.

WILLIAM T. CHIDLAW,
Counsel of Record,
Law Offices of,
WILLIAM T. CHIDLAW,
A Professional corporation,
Point West Executive Centre,
1455 Response Road, Suite 191,
Sacramento, Calif. 95815,
(916) 920-0202.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

Petitioner Wine & Spirits Wholesalers of California respectfully petitions this Court for a Writ of Certiorari to review the final judgment of the Court of Appeal of the State of California, Third Appellate District, granting a peremptory writ of mandate permanently enjoining enforcement of the "primary source" provisions of California Business and Professions Code § 23672.

Questions Presented for Review.

This petition presents for review the following questions relating to the validity of California's "primary source" law, which (a) limits the importers who may purchase or accept delivery of a brand of distilled spirits to those licensed importers who have been designated by the brand owner or his designee, and (b) effectively requires California importers to obtain brands of distilled spirits directly from the primary source, *e.g.*, brand owner or distiller.

1. Whether California's primary source law, *on its face*, compels a *per se* violation of the Sherman Act and is preempted under the Supremacy Clause although the statute does no more than enforce a vertical allocation of the wholesale market for branded distilled spirits in California.

2. Whether in determining the validity of a state statute under the Sherman Act, where a clearly articulated state policy is acknowledged, the "state action" exemption may be held inapplicable before the statute has become effective and before the State has been afforded a reasonable opportunity to exercise its "active supervision."

3. Whether the Twenty-first Amendment to the United States Constitution bars preemption of California's primary source law by the Sherman Act and the Commerce Clause, on the grounds that the state statute is within the State's virtually complete authority over liquor importation and the structure of its liquor distribution system.

4. Whether the Commerce Clause, by its express terms, preempts California's primary source law absent any evidence that the statute will unduly restrict the overall flow of interstate commerce.

Parties.

The parties in this case are as follows:

1. Petitioner herein is Wine & Spirits Wholesalers of California, a California corporation, an intervenor below. Petitioner does not have any parent or subsidiary corporations or affiliates.

2. Respondent below is Baxter Rice, Director, Department of Alcoholic Beverage Control.

3. The other intervenor below is Bohemian Distributing Company, a California corporation.

4. Respondents herein, petitioners below, are Norman Williams Company, a California corporation; Schwab Distributing Company, Inc., a California corporation d/b/a Gold Coast Wines & Spirits; Lewis Westco & Co., a California corporation; Greene Cat Liquors, Inc., a California corporation; Frederica Auldridge d/b/a South Bay Liquor; Ralph E. Pierce and Sharon L. Pierce d/b/a Texas Liquor House; and William A. Kirby, Jr. and Shirley D. Kirby d/b/a House of Fine Spirits.

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WINE & SPIRITS WHOLESALERS OF CALIFORNIA, a California corporation

Petitioner,

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NORMAN WILLIAMS COMPANY, etc., *et al.*,

Respondents.

Petition for Writ of Certiorari to the Court of Appeal of the State of California, Third Appellate District.

Opinion Below.

The Opinion of the California Court of Appeal, Third Appellate District, is officially reported as *Norman Williams Co. v. Rice,* 108 Cal. App. 3d 348 (1980), and is reprinted herein as Appendix A.[1]

Jurisdiction.

The judgment of the California Court of Appeal was entered on July 17, 1980 and is set forth in the Court of Appeal's above Opinion, reprinted herein as Appendix A. A timely Petition for Hearing, filed by Wine & Spirits Wholesalers Association of California in the California Su-

[1]The Appendices to this petition are occasionally cited hereinafter as "App."

preme Court, was denied by that court on September 24, 1980. The order of denial is reprinted herein as Appendix B.

Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(3).

Constitutional and Statutory Provisions.

This case involves the following constitutional and statutory provisions, which provide as relevant:

U.S. Const. art. I, § 8, cl. 3 (Commerce Clause):

> "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States . . . ."

U.S. Const. art. VI, cl. 2 (Supremacy Clause):

> "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any thing in the Constitution or Laws of any State to the Contrary notwithstanding."

U.S. Const., amend. XXI, § 2:

> "The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

Sherman Act § 1, 15 U.S.C. § 1:

> "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal."

Sherman Act § 2, 15 U.S.C. § 2:

> "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other

person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . . ."

Cal. Bus. & Prof. Code § 23672, as amended by Assembly Bill No. 499 (Stats. 1979, Ch. 208, § 1):

"A licensed importer shall not purchase or accept delivery of any brand of distilled spirits unless he is designated as an authorized importer of such brand by the brand owner or his authorized agent."

Certain relevant laws and a regulation of the State of Oklahoma are set forth herein in Appendix C.

Statement of the Case.

This case was commenced by petitioners below as an original writ proceeding in the California Court of Appeal, Third Appellate District, to adjudicate the validity of California Business and Professions Code § 23672, as amended by Assembly Bill No. 499 (Stats. 1979, Ch. 208, § 1) (the "Designation Statute"). In pertinent part, as amended, the Designation Statute provides: "A licensed importer shall not purchase or accept delivery of any brand of distilled spirits unless he is designated as an authorized importer of such brand by the brand owner or his authorized agent."[2]

Petitioners below (sometimes collectively referred to herein as "Williams Company") are three California importer-wholesalers[3] of distilled spirits and four of their retail customers. Respondent below is Baxter Rice, Director of the California Department of Alcoholic Beverage Control.

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[2]The validity of the last sentence of the Designation Statute, which requires that imported distilled spirits "come to rest" at the importer's warehouse, was not challenged by Williams Company and is not in issue in this case. (See App. A at 19-20.)

[3]Under Cal. Bus. & Prof. Code § 23775, in order to be a licensed importer it is necessary to have a California wholesaler's license.

Wine & Spirits Wholesalers of California ("Wholesalers Association"), a statewide association of licensed importers and wholesalers of distilled spirits, and Bohemian Distributing Company, a California importer-wholesaler, were granted leave to intervene for purposes of defending against Williams Company's claims.

By an amended petition for writ of mandate filed on November 20, 1979, Williams Company alleged, among other things, that the Designation Statute "is inconsistent with and preempted by the Federal antitrust laws. . . ." Petitioners below expressly limited their challenge to the validity of the Statute on its face and disclaimed the necessity of a trial on the facts. On December 31, 1979, one day prior to the effective date of Assembly Bill No. 499, the Court of Appeal issued an alternative writ and stayed the operation of the Designation Statute pending resolution of the case on its merits. The Court of Appeal, in ultimately striking down the Designation Statute, rested its final decision exclusively on federal grounds. In its Opinion (App. A), the Court of Appeal ruled that the Designation Statute is invalid because it purportedly is in "direct contravention of the express terms of the Commerce Clause and the Sherman Act."[4] App. A at 12. Consistent with the issues as framed by the Amended Petition, the Court based its determination solely on the facial validity of the Designation Statute and declined to consider any evidentiary material presented by Williams Company. App. A at 2 n.1.

The federal issues were briefed and argued in a Petition for Hearing before the California Supreme Court, which

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[4]The effect of the Commerce Clause, as an independent basis for decision, had not been addressed by the parties in the proceedings before the Court of Appeal. The issue was raised *sua sponte* by the Court of Appeal in its Opinion.

declined to review the judgment. On September 25, 1980, one day after the California Supreme Court denied a hearing, the Court of Appeal issued a peremptory writ of mandate permanently enjoining enforcement of the Designation Statute. App. D.

The Designation Statute is an integral part of California's comprehensive scheme for regulating the importation and distribution of distilled spirits.[5] The vast majority of distilled spirits consumed in California are imported from sources outside the State, and the great bulk of imported distilled spirits consist of brands owned by distillers and other primary sources of supply. The Designation Statute effects a vertical allocation of the wholesale liquor market in brands to designated importer-wholesalers, and it also assures that distilled spirits are imported directly from the primary source.[6] In this latter respect the Statute is similar in effect to "primary source" laws enacted in the District of Columbia and in seventeen other States.[7]

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[5]The Designation Statute was enacted as part of California's Alcoholic Beverage Control Act (Cal. Bus. & Prof. Code § 23000 *et seq.*), the express purposes of which are in relevant part as follows:

> "This division is an exercise of the police powers of the State . . . . It is hereby declared that the subject matter of this division involves in the highest degree the economic, social, and moral well-being and the safety of the State and of all its people. All provisions of this divisicn shall be liberally construed for the accomplishment of these purposes." *Id.* at § 23001.

[6]Typically, insofar as the three-tier system of liquor distribution is concerned, primary source laws provide assurance that importations of alcoholic beverages (1) will originate only from the distiller or other reliable source of supply and (2) will occur entirely through regular and established channels of distribution. Primary source laws are supportive of the triple-tiered system of liquor distribution found in many states, including California.

[7]The other jurisdictions requiring wholesalers to purchase alcoholic beverages from primary sources and the relevant statutes are set out in Appendix E. There is an especially striking similarity between the Designation Statute and the primary source statutes of Connecticut, Illinois, Maryland and Nebraska. Like the California statute, the statutes in each of these four states vertically allocate the wholesale market by requiring that the manufacturer select certain wholesalers as authorized distributors.

Historically, California's system of liquor distribution and its entire regulatory scheme have been premised on a statutorily-mandated "three-tier" structure consisting of the supplier tier (*e.g.*, the distiller), the wholesaler tier (*i.e.*, the importer-wholesaler) and the retailer tier (*i.e.*, the retail outlet) — all of which are to remain distinct and separate. *See* Cal. Bus. & Prof. Code § 25500 *et seq.; also California Beer Wholesalers Assn., Inc. v. Alcoholic Bev., Etc. Appeals Bd.*, 5 Cal. 3d 402, 407, 412, 487 P.2d 745, 96 Cal. Rptr. 267 (1971).) For many years prior to the enactment of the original 1973 version of the Designation Statute (Stats. 1973, Ch. 707, § 1), it was common practice for licensed importers to purchase distilled spirits directly from the "primary source" which, through private agreement, had designated such importers as authorized distributors. Many of the existing designations pre-date World War II.

The 1973 version of the Designation Statute was enacted in response to a situation occasioned by Oklahoma law which threatened to irreparably disrupt California's historic system for importation and distribution of branded distilled spirits. Specifically, the California system has been characterized by shipment from the out-of-state distillers or brand owners directly to designated California importer-wholesalers. In sharp contrast to the distribution system in California and most other states, under Oklahoma law all distillers marketing in Oklahoma must sell distilled spirits to any and all licensed Oklahoma wholesalers. Okla. Stat. tit. 37 § 533. This practice commonly is known as "open wholesaling."[8] Distillers may not place a limit on quantity

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[8]Minnesota is the only other State which requires "open wholesaling" (Minn. Stat. Ann. § 340.114), a practice whereby all liquor wholesalers are entitled to purchase all brands marketed in the state. Unlike Oklahoma, however, Minnesota prohibits that State's wholesalers from selling out-of-state without the supplier's permission. Minn. Stat. Ann. § 340.145. *See* Dakota Wholesale Liquor v. Minnesota, 584 F.2d 847, 848 (8th Cir. 1978) (affirming the denial of a motion to enjoin enforcement of Minnesota's prohibition of such exports).

and are required to fill orders in the sequence received, at prices no higher than the prices charged to wholesalers in any other state.[9] *Id.* at § 536.1; Regulations of the Oklahoma Beverage Control Board, Art. 3, § 521(3). *See also* App. A at 4. Furthermore, Oklahoma wholesalers are expressly authorized to resell distilled spirits out-of-state to all "qualified persons." Okla. Stat. tit. 37, § 521(e). *See also* App. A at 4. Thus, absent a California law prohibiting importation of Oklahoma resales into the State, Oklahoma law permits an Oklahoma wholesaler to order liquor from a distiller for delivery in Oklahoma and then either reroute the shipment to California while it is in transit or reship it to California after delivery in Oklahoma.

When originally enacted in 1973 to prevent the flow of branded distilled spirits from Oklahoma to nondesignated California importers, the Designation Statute prohibited an importer from purchasing or accepting delivery of any branded distilled spirits unless designated as the authorized importer "by the *licensee who filed the minimum price schedule for such brand* pursuant to Business and Professions Code § 24755." (Stats. 1973, Ch. 707, § 1 emphasis added). Under California Business and Professions Code section 24755 brand owners or their designees were required to file a minimum price schedule with the Department of Alcoholic Beverage Control in connection with the price maintenance feature of California's liquor fair trade laws.

In May 1978, the California Supreme Court, in *Rice v. Alcoholic Beverage Control Appeals Board*, 21 Cal. 3d 431,

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[9]This regulation, providing in effect that wholesalers receive the benefit of the lowest price at which liquor is offered to wholesalers elsewhere in the nation, is a so-called "price affirmation" law. In 1979, California enacted a similar law (Cal. Bus. & Prof. Code § 23673) which became operative on the same effective date that the Designation Statute was to take effect.

579 P.2d 476, 146 Cal. Rptr. 585 (1978) ("*Rice*"), held that § 24755 was invalid because it was part of a statutory price-fixing scheme preempted by the Sherman Act. The validity of the Designation Statute was not questioned in the *Rice* case. Nevertheless, the California Department of Alcoholic Beverage Control took the position that the *Rice* decision rendered the Designation Statute unenforceable because there was no longer any licensee required to file a minimum price schedule. App. A at 4.

Thereafter, a number of nondesignated importers, including some of the petitioners below and certain Oklahoma wholesalers moved to exploit the gap in the law resulting from the decision in *Rice*. The Oklahoma wholesalers began purchasing leading brands of distilled spirits at the lowest prices available in the nation exclusively for resale outside of Oklahoma, and the nondesignated California importer-wholesalers began purchasing brands from Oklahoma wholesalers for resale in California. This "Oklahoma connection," so described by the California Court of Appeal (App. A at 4), had the effect of (1) forcing Oklahoma's anomalous "open wholesaling" system of liquor distribution on California, (2) superimposing a "fourth tier," consisting of the Oklahoma jobbers, onto California's three-tier system of liquor distribution, and (3) materially disrupting California's historic system of obtaining imports of branded distilled spirits directly from the distiller or other primary source.

In order to restore California's historic system of liquor importation and wholesale distribution and to avert the disruption of the California wholesale market threatened by the Oklahoma connection, in 1979 the California Legislature passed Assembly Bill No. 499, which amended the Designation Statute, eliminating the reference to California Business and Professions Code § 24755. In substance, the

amendment provided that a California importer shall not purchase or obtain a brand of distilled spirits "unless he is designated as authorized importer" by the brand owner.

By reason of the stay issued by the Court of Appeal, followed ultimately by the issuance of a peremptory writ, the Designation Statute, as amended by Assembly Bill No. 499, never was allowed to take effect.

REASONS FOR GRANTING THE WRIT.

A. Preliminary Statement.

For each of the following reasons, a Writ of Certiorari should be issued in this case to secure uniformity of decision, resolving judgments recently in conflict, and to settle important questions of federal law bearing directly on the authority of the States (1) to control the importation of distilled spirits and (2) to structure a system of wholesale liquor distribution. Under the Twenty-first Amendment, these have been matters wherein the State historically has been accorded wide latitude in advancing its legitimate regulatory interests.

First, the California Court's decision in this case is in direct conflict with the decision of the Kansas Supreme Court in *Colby Distributing Co., Inc. v. Lennen*, 227 Kan. 179, 606 P.2d 102 (1980), sustaining the validity of a similar law on the grounds, here pertinent, that it was sanctioned by the Twenty-first Amendment and was compatible with the antitrust laws. Furthermore, the instant case is in conflict with the recent decision of this Court summarily dismissing, for want of a substantial federal question, an appeal from the judgment in *Colby Distributing Co., Inc. v. Lennen*, 227 Kan. 179, 606 P.2d 102, *sub nom. Grant-Billingsley Wholesale Liquor Co., Inc. v. Lennen*, 49 U.S.L.W. 3331 (Nov. 3, 1980). A resolution of this conflict is necessary to secure uniformity of decision and to avert a multiplicity of litigation which the appellate court's dangerous precedent otherwise would portend, as this is a matter which is of immediate concern not only in California, but in at least *eighteen* other jurisdictions with laws similar to the Designation Statute.

Second, in creating an entirely new category of *per se* Sherman Act violation as a basis for invalidating the Designation Statute *on its face*, the California Court of Appeal

reached a conclusion totally at variance with this Court's decision in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), which reaffirmed the principle that privately imposed vertical territorial and customer restraints, analogous to those which may exist under the Designation Statute, are subject to antitrust analysis under the rule of reason, not a *per se* rule of illegality. The Court of Appeal erroneously purported to limit *GTE Sylvania* to situations in which there is a mere unilateral refusal to deal.

Third, the California Court of Appeal prematurely rejected application of the "state action" exemption to the antitrust laws, on the ground that the Designation Statute is "devoid of state involvement." App. A at 13. Since the Designation Statute, as amended by Assembly Bill No. 499, has not been permitted to take effect and the State has not been given a reasonable opportunity to adopt appropriate regulations for supervising the operation of the Statute, the lower court's disallowance of the exemption is manifestly improvident. Moreover, the effect of the Court of Appeal's ruling is to engraft on the state action exemption the oppressive requirement that the State adopt a comprehensive supervisory scheme in advance of a statute's effective date and without having the benefit of monitoring the statute in operation.

Fourth, the California Court of Appeal's ruling contravenes this Court's recent decision in *California Retail Liquor Dealers Assn. v. Midcal Aluminum, Inc.*, 445 U.S. 97, 63 L. Ed. 2d 233, 100 S. Ct. 937 (1980), holding that the Twenty-first Amendment "grants the states virtually complete control over whether to permit *importation* or sale of liquor and how to structure the *liquor distribution* system." 100 S. Ct. at 946 (emphasis added). By concluding, without analysis, that the Designation Statute "does not relate to the decision whether to permit the importation and sale of

liquor and is not a part of the establishment of the channels of distribution" (App. A at 15), the California Court of Appeal completely misconstrued and erroneously applied this Court's holding in *Midcal*. The intervention of this Court is necessary to clarify the scope of the State's power to control imports and structure a liquor distribution system.

Fifth, the California Court of Appeal's reliance upon the Commerce Clause of the United States Constitution as an independent basis for invalidating the Designation Statute effectively gives the Commerce Clause an expansive construction which conflicts with applicable decisions of this Court and the United States Court of Appeals for the Fourth Circuit.

B. The Decision of the California Court of Appeal Is in Conflict With the Decision of the Kansas Supreme Court in *Colby* Upholding a Kansas Statute Directly Analogous to the Designation Statute.

In *Colby Distributing Co., Inc. v. Lennen*, 227 Kan. 179, 606 P.2d 102 (1980), the Kansas Supreme Court rejected a Sherman Act challenge to the validity of Kansas House Bill No. 2020 (the "Kansas Law"), which, similarly to the Designation Statute, mandates a vertical allocation of the wholesale branded liquor market to designated wholesalers and thereby effectively eliminates "open wholesaling" which previously existed in Kansas. In addition, the Kansas Law requires the creation of exclusive territorial distributorships.

The Kansas Law accomplishes these objectives in two ways. First, it prohibits wholesalers from selling any brands of distilled spirits in the State unless there is filed with the State a written agreement between the wholesaler and distiller specifying the territory within which the wholesaler is permitted to sell the brand to retailers. 606 P.2d at 106.

To this extent, the Kansas Law is functionally indistinguishable from the Designation Statute. That is to say, the Kansas Law prohibits Kansas wholesale distributors from selling liquor unless they have obtained proper authorization from the distiller, and the Designation Statute prohibits California importer-wholesalers from purchasing or accepting delivery of distilled spirits unless designated by the brand owner.

The second pertinent aspect of the Kansas Law is not found in California. The Kansas Law prohibits a supplier from granting a franchise for the distribution of a brand to more than one wholesaler for all or any part of a specified territory, which may include all or part of Kansas. *Id.* at 106, 110. The Designation Statute does not place any limit on the number of importers a brand owner may designate in a given territory, leaving open the opportunity for intra-brand competition which is foreclosed in Kansas.

In respects here pertinent, the Kansas Supreme Court, construing federal law, held that (1) the Kansas Law constitutes a valid exercise of the power reserved to the States by the Twenty-first Amendment to regulate the distribution of liquor within the State (*Id.* at 111); and (2) "[t]he provisions of [the Kansas Law] on its [*sic*] face will allow sufficient brand and price competition to withstand allegations of a violation of the Sherman Anti-Trust Act;" and thus, the Kansas Law is not invalid under the Supremacy Clause. *Id.* at 110.

Both of the federal constitutional grounds upon which the Kansas Supreme Court relied in *Colby* were presented to this Court on appeal in appellant's Jurisdictional Statement, and both appellant and appellees thoroughly argued these points in their respective briefs submitted on appeal. This Court's summary dismissal of the appeal from *Colby* for want of a substantial federal question is a judgment on the

merits, affirming the alternative holding of the Kansas Supreme Court interpreting federal law. *See Hicks v. Miranda*, 422 U.S. 332, 344-45 (1975); *Mandel v. Bradley*, 432 U.S. 173, 176 (1980) (Brennan, J., concurring).

The holding of the California Court of Appeal in the instant case thus clashes sharply with the decision in *Colby*. If anything, the circumstances that the Designation Statute (1) *does not* require the creation of exclusive territories and (2) *does* directly affect the *importation* of distilled spirits, factors not in issue in *Colby*, provide an even more compelling reason for sustaining the California law.

C. Unlike the Statutorily-Imposed Price Fixing Scheme Invalidated in *Midcal*, the Designation Statute Does Not Compel a Sherman Act Violation. In Reaching a Contrary Conclusion, the Court of Appeal Fundamentally Misapplied This Court's Decision in *GTE Sylvania*.

There is a "strong policy against invalidating state regulatory schemes [on preemption grounds] in the absence of a clear showing of *irreconcilable conflict* with federal law . . . ." *Swift & Company, Inc. v. Wickham*, 364 F.2d 241, 246 (2d Cir. 1966), *cert. denied*, 385 U.S. 1036 (1967) (emphasis added). The federal antitrust laws do not preempt a state law merely because it has an anticompetitive effect. *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 133 (1978).[10] A conflict does not arise unless the state law *compels* private conduct which violates the antitrust laws. *Joseph E. Seagram & Sons, Inc. v. Hostetter*, 384 U.S. 35, 45-46 (1966).

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[10]In *Exxon*, this Court noted that "if an adverse effect on competition were, in and of itself, enough to render a state statute invalid, the States' power to engage in economic regulation would be effectively destroyed." 437 U.S. at 133 (footnote omitted).

Nothing on the face of the Designation Statute compels or purports to authorize conduct which would violate the Sherman Act. *The Designation Statute leaves each brand owner free to designate as few or as many importers as are consistent with his private marketing decisions.* Further, nothing in the Designation Statute prevents a brand owner from designating every importer in the State, and nothing prevents an importer from negotiating freely with a brand owner to obtain his designation. *Compare Colby*, 606 P.2d at 110. If brand owners or importers implement their marketing decisions in a manner which unreasonably restrains commerce in violation of the Sherman Act, they remain subject to antitrust scrutiny and to the full panoply of civil and criminal sanctions available when a Sherman Act violation occurs. *The mere possibility of abuse does not provide a basis for invalidating the state statute.*[11] *See Joseph E. Seagram & Sons, Inc. v. Hostetter, supra*, 384 U.S. 35, 45-46 (1966); *Colby*, 606 P.2d at 110.

Because the Designation Statute does not compel an antitrust violation, this case stands in vivid contrast to the decisions in *Midcal* and *Rice*, in which California's retail price maintenance and price posting statutes were invalidated because they mandated the creation of a "private price fixing arrangement," a *per se* violation of the Sherman Act (*Midcal*, 100 S. Ct. at 944). No such statutory compulsion exists here.

The Court of Appeal in this case conceded that the Designation Statute is "unique" and does not conveniently fall into any previously recognized categories of *per se* violation of the Sherman Act. App. A at 9. Nevertheless, the appellate

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[11]It is submitted that where a state law, on its face, does not compel conduct offensive to the Sherman Act, the state enactment is not subject to scrutiny under either the *per se* doctrine or the rule of reason analysis. Instead, it is the conduct of private parties which must be examined.

court concluded that the Designation Statute violates the Sherman Act because by limiting the importers who may import a particular brand to those designated by the brand owner or his designee, the Statute "gives private parties the unfettered power to forbid interstate trade between other private parties." App. A at 12. In reaching this conclusion, without the benefit of any factual analysis or consideration of the legitimate purposes subserved by the Designation Statute, the Court of Appeal not only created an entirely new form of *per se* Sherman Act violation but precipitously reached a conclusion completely contrary to the decision of this Court in *Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. 36 (1977).

In this regard, *GTE Sylvania* reaffirmed the principle that a manufacturer's selective designation of its distributors and imposition of vertical restrictions as to where and to whom they may sell, are subject to a rule of reason analysis. 433 U.S. at 58-59. This Court in *GTE Sylvania* expressly overruled the contrary holding in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), which had invalidated a franchising system that prohibited sales to non-franchised retailers. In *Schwinn* the vertical restriction was deemed *per se* illegal, the majority ruling that "it is unreasonable without more" for a manufacturer to restrict the markets in an article once the manufacturer has parted with title to it. 388 U.S. at 379.

In rejecting the inflexible approach of *Schwinn* in favor of a return to the rule of reason, the Court in *GTE Sylvania* concluded that *Schwinn* represented "an abrupt and largely unexplained departure from White Motor Co. v. United States, 372 US 253, 9 L Ed 2d 738, 83 S Ct 696 (1963), where only four years earlier the Court had refused to endorse a per se rule for vertical restrictions." *GTE Sylvania*, 433 U.S. at 47. The Court expressly recognized that vertical

customer and territorial restrictions may have significant "redeeming virtues," such as promoting interbrand competition by enabling the manufacturer to achieve certain efficiencies in the distribution of his product. *Id.* at 51 n.19, 54-55. Because there had been no showing that vertical restrictions, either generally or of the type used by Sylvania, "have a 'pernicious effect on competition' or . . . 'lack . . . any redeeming virtue,' " the Court concluded that the "per se rule stated in Schwinn must be overruled." *Id.* at 58 (citation and footnotes omitted). The Court emphasized that "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than — as in Schwinn — upon formalistic line drawing." *Id.* at 58-59.

In purporting to create a new variety of *per se* Sherman Act violation in this case, the Court of Appeal embarked on precisely the same process of "formalistic line drawing" employed in *Schwinn* and subsequently rejected in *GTE Sylvania*. The Court of Appeal ruled that the Designation Statute violates the Sherman Act solely because the statute "allows the manufacturer to forbid others to sell to a disfavored importer." App. A at 10. Because the Court began with the premise that the Designation Statute is illegal *per se*, it failed to evaluate the actual economic effect of the Statute on competition in the market and whether the Statute has "any redeeming virtue."[12] The court manifestly failed

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[12]Proper application of the principles set forth in *GTE Sylvania* is not merely an academic exercise in this case. The Court of Appeal implicitly recognized eight separate state purposes advanced in support of the Designation Statute. App. A at 16-17. For example, the Statute facilitates the monitoring and tracing of imported distilled spirits. By eliminating the Oklahoma jobber as a fourth tier or level of distribution, the Statute unquestionably has simplified the State's responsibility in checking the flow of alcohol into California. It was clearly demonstrated to the Court of Appeal that the Designation Statute serves a number of important state interests and it cannot be concluded that the Statute is so totally lacking in redeeming value as to merit the Court of Appeal's superficial treatment.

to point to any facts, applicable precedent or persuasive analysis which would justify a *per se* rule of illegality in this case.[13]

The fundamental error in the Court of Appeal's reasoning is highlighted by its analysis of *GTE Sylvania*. The appellate court stated:

> "We find the decision in *Continental T.V. Inc. v. GTE Sylvania Inc.* to be inapposite to the statutory provision which we consider. That case involved a manufacturer's chosen method of product distribution enforced by a refusal to sell to retailers outside of their assigned territories. Petitioners herein do not attack the decision of distillers to refuse to trade with them; rather, they attack the state-provided authority of the distillers to prohibit them from trading with others. Nothing in *Continental T.V. Inc. v. GTE Sylvania Inc.* authorizes a state to delegate such power to a private party." App. A at 11.

Contrary to the suggestion of the Court of Appeal, the issue in *GTE Sylvania* was *not* the validity of a simple *unilateral* refusal to deal. The issue addressed by this Court in both *GTE Sylvania* and *Schwinn* was the legality of *agreements* between a manufacturer and retailers prohibiting the retailers from dealing with third parties after such retailers had acquired title to the merchandise. The Court of Appeal seriously misconstrued *GTE Sylvania* by focusing on the *man-*

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[13]This Court has repeatedly counselled caution and judicial restraint with respect to new departures from the rule of reason. For example, in *White Motor Co. v. United States*, *supra*, 372 U.S. 253, 263 (1963), this Court noted that "[w]e need to know more than we do about the actual impact of these [vertical] arrangements on competition to decide whether they have such a 'pernicious effect on competition and lack . . . any redeeming virtue' and therefore should be classified as *per se* violations of the Sherman Act." (Citation omitted.)

ner in which the restriction was created and enforced rather than on its *effect*.

In the instant matter, therefore, *GTE Sylvania* is instructive in that it demonstrates that the kind of vertical allocation enforced here by the Designation Statute, if arranged solely by private parties, cannot be classified as a *per se* antitrust violation. *A fortiori*, the state-mandated vertical restraint under the Designation Statute could not conceivably be the basis for a *per se* violation. Had the Court of Appeal properly understood the approach required by *GTE Sylvania*, it would have ascertained that the Designation Statute does not compel a Sherman Act violation and accomplishes nothing which could not be lawfully accomplished under free market conditions in a manner consistent with the Sherman Act. It is clear that absent any state regulation, brand owners are free to select their own distributors (*United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919); *Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd.*, 416 F.2d 71, 76, 78 (9th Cir. 1969), *cert. denied*, 396 U.S. 1062 (1970)), and a limitation on resale to non-designated distributors would *not* constitute a *per se* violation of the Sherman Act. Nothing in the antitrust laws requires "open wholesaling" whereby *all* importers have access to all brands. *Colby*, 606 P.2d at 110. The Oklahoma regulatory scheme disrupts the free market distribution system by artificially restricting the ability of brand owners to select their distributors; but the Designation Statute, without infringing on the operation of the Oklahoma scheme in Oklahoma, merely prevents that scheme from expanding beyond Oklahoma's territorial borders into California.

On this record it cannot be concluded that the Designation Statute is in "irreconcilable conflict" with federal antitrust law. In reaching a contrary conclusion, the Court of Appeal failed to recognize that the Designation Statute does not

compel conduct which violates the Sherman Act and does not immunize from judicial scrutiny private conduct resulting in an unreasonable restraint on trade. The Court of Appeal in the instant case violated the fundamental precept that " 'enjoin[s] seeking out conflicts between state and federal regulation where none clearly exists.' " *Joseph E. Seagram & Sons, Inc. v. Hostetter, supra*, 384 U.S. 35, 45 (1966) (citation omitted).

D. The Designation Statute Constitutes "State Action" Which Is Exempt From Federal Antitrust Laws.

The lower court acted prematurely in rejecting the "state action" exemption (App. A at 13), thereby misconstruing the federal standards which should govern the matter. Even if the Designation Statute required conduct which ordinarily would be prohibited by the Sherman Act, which Wholesalers Association disputes, the State's continuing supervision and participation in the regulatory scheme qualifies the Designation Statute for antitrust exemption under the "state action" doctrine of *Parker v. Brown*, 317 U.S. 341 (1943).

In *Midcal*, this Court articulated two essential elements of antitrust immunity under the state action doctrine: "First, the challenged restraint must be 'one clearly articulated and affirmatively expressed as state policy'; second, the policy must be 'actively supervised' by the State itself." 100 S. Ct. at 943.

There can be no dispute, and the California Court did not disagree, that the first requirement, namely a clearly declared "state policy," is satisfied in this case. However, the Court of Appeal's decision invalidating the Designation Statute effectively foreclosed the *opportunity* for the State to meet the second requirement.

There presently exists in California a comprehensive regulatory scheme of which the Designation Statute is a con-

stituent part. The California Alcoholic Beverage Control Act requires the supervisory agency, the Department of Alcoholic Beverage Control, to control, monitor and maintain continuous close supervision over the importation, distribution and taxation of alcohol on a continuing basis. If the Designation Statute had become effective, the Department would have had an opportunity to monitor and assess the effect of the Designation Statute and issue appropriate regulations under its authority to "make and prescribe such Bus. & Prof. Code § 25750; *see also* Cal. Const. art. XX, § 22. In fact, as of the declared effective date of the Designation Statute, the Department had already begun to issue regulations which included a requirement that brand owners shipping distilled spirits identify the importer-wholesalers whom they have designated. (See App. F, a copy of the Department's instructions to out-of-state shippers of distilled spirits.)

It cannot be lightly assumed, as the lower court did, that the Department will completely abdicate its statutory responsibilities or fail to enact appropriate rules and regulations if it determines that such action is necessary. In essence, the appellate court's judgment required adoption and supervision of a regulatory scheme even before the effective date of the Designation Statute. Accordingly, the ruling of the lower court on the "state action" exemption should be reversed in order to afford the California enforcement agency the opportunity to perform its administrative duties.

E. The Twenty-first Amendment of the United States Constitution Bars Application of the Sherman Act to the Designation Statute.

The Designation Statute, as a regulation of both *importation* and *distribution of liquor*, constitutes an exercise of state authority of the highest order under the Twenty-first

Amendment. In *Midcal*, this Court reconfirmed the principle that the Amendment reserves to the States almost plenary power over "[1] *whether to permit importation or sale of liquor and* [2] *how to structure the liquor distribution system.*" 100 S. Ct. at 946 (emphasis added). Petitioner submits that this reaffirmation in *Midcal* attests to the paramount constitutional stature of the Designation Statute.

As previously demonstrated, the California Court of Appeal committed palpable error in finding that the Designation Statute contravenes the Sherman Act. But even assuming such a conflict between state and federal law existed, that would only be the beginning of the inquiry. In recognition of the broad authority granted to the States by the Twenty-first Amendment, this Court in *Midcal* has established a two-part test to determine whether a state regulation of alcohol is preempted by the Sherman Act. The "threshold question," as framed by this Court, is whether the state scheme conflicts irreconcilably with the Sherman Act. 100 S. Ct. at 941.

Once a "threshold" finding of irreconcilable conflict has been made, *Midcal* requires the employment of two independent, alternative criteria for gauging the extent of antitrust immunity which derives from the Twenty-first Amendment. The first criterion, which governs the instant matter, requires merely that a determination be made whether the statute pertains to the *importation* or *distribution* of liquor *within* the State. If that is the case, *Midcal* is conclusive that the state law is exempt from the federal commerce power, and there is no necessity to balance such regulation against the national policy underlying the antitrust laws. The reason is that the States possess "virtually complete control" over importation and distribution, according to this Court's explanation of the "explicit grant of authority" in Section 2 of the Twenty-first Amendment. 100 S. Ct. at

944, 946. In contrast, where state regulations touch on matters not related to importation and distribution, a more thoroughgoing examination is required and "those [state] controls may be subject to the federal commerce power in appropriate situations." 100 S. Ct. at 946.

Notwithstanding *Midcal's* pronouncement on the force of the Amendment, the Court of Appeal erred in two fundamental respects in its construction of the Twenty-first Amendment and the Designation Statute. First, construing the Statute's terms, a matter of profound federal consequence, the Court asserted that the Designation Statute "does not relate to the decision whether to permit the importation and sale of liquor and is not a part of the establishment of the channels of distribution."[14] App. A at 15. Second, as a result of its first error, the appellate court interjected an antitrust balancing test in its analysis of the Designation Statute. All considered, these errors precipitated a serious erosion of an area of state authority central to the Amendment's most basic application, namely *importation* and *distribution*. As will be explained more particularly herein, the Designation Statute falls squarely within the terms of the Amendment, and therefore the appellate court's inquiry should have terminated without the necessity of a balancing test.

The Designation Statute, by its terms, expressly and unambiguously provides that a California importer "shall not purchase or accept delivery of any brand of distilled spirits,"

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[14]The Appellate Court's unfounded conclusion that the Designation Statute does not relate to importation or distribution is internally contradictory. Initially, the Court of Appeal held that the Designation Statute violated the Sherman Act because it affects "interstate trade" in distilled spirits. App. A at 12. Later, however, the Court stated inconsistently that the Statute does not regulate the "importation" of liquor and is therefore not entitled to the protection of the Twenty-first Amendment. App. A at 15.

unless the appropriate designation has been made. The Statute thus reflects the policy of California to permit the importation of branded liquor into California, only upon certain conditions as set forth in the Statute. Insofar as the Designation Statute closes the Oklahoma connection, excluding from California branded liquor not purchased by an "authorized" importer, the Statute comes precisely within the Amendment's pivotal language restoring to the States the control of "transportation or importation" of liquor into their territories. *See Midcal, supra,* 100 S. Ct. at 944.

Historically, restrictions on the transportation of liquor into a State have been held to comport fully with the discretionary power accorded to the State in deciding how to limit importations. In this regard, this Court in *Midcal* acknowledged that its "early decisions on the Twenty-first Amendment recognized that each state holds great power over the importation of liquor from other jurisdictions." 100 S. Ct. at 944. For example, when this Court first examined the Amendment after its adoption, addressing the range of state authority over imports, Justice Brandeis stated: "Can it be doubted that a state might . . . prohibit all competing importations . . . or channelize desired importations by confining them to a single consignee?" *State Board of Equalization v. Young's Market Co.,* 299 U.S. 59, 63 (1936). *See e.g., Mahoney v. Joseph Triner Corp.,* 304 U.S. 401 (1938) (Upholding law restricting types of liquor that can be imported from other states).

By its necessary effect, the Designation Statute also pertains to the structure of the liquor distribution system in California. The Statute will "channel" imports of brands directly to California importer-wholesalers, precluding intervention of a new "fourth" tier of Oklahoma jobbers between the first "primary source" tier and the second "wholesale" tier. Further, the Statute will result in the

delivery of brands exclusively to designated wholesalers for distribution in the State, and accordingly the Statute in effect will allocate the wholesale distribution market to selected distributors. Without the limitations imposed by the Designation Statute, however, a variant of Oklahoma's "open wholesaling" system will be introduced into the California structure of distribution, necessarily permitting any wholesaler to have access to any brand by reason of the Oklahoma connection. In this respect, the Designation Statute reflects the intention of the Legislature not to impose "open wholesaling" on the California structure of distribution, and such legislative choice is consistent with this Court's expansive view of the State's rights under the Twenty-first Amendment. *See Young's Market, supra*, 299 U.S. at 63, "Surely the State may adopt a lesser degree of regulation than total prohibition. . . . [A] state might establish a state monopoly of the manufacture and sale of beer. . . ."

In summation, the appellate court gravely misapprehended both the express wording and the intendment of the Designation Statute, each of which has implications of paramount constitutional dimension. The result was a profound misapplication of *Midcal* and an astounding digression from earlier decisions of this Court, upholding the State's sweeping authority to regulate the subjects incorporated in the Designation Statute, not fettered by the Sherman Act.[15]

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[15]This Court commented in *Midcal* that the Twenty-first Amendment grants the State "special power" to enact economic regulations relating to liquor importation and distribution. *Midcal, supra*, 100 S. Ct. at 945. While this Court has recognized that the Amendment did not completely abrogate federal authority over commerce in distilled spirits, this Court has never retreated from the position that " 'a State is totally unconfined by traditional Commerce Clause limitations when it restricts the importation of intoxicants destined for use, distribution or consumption within its borders.' " *California v. La Rue*, 409 U.S. 109, 114 (1972). *Accord: Midcal, supra*, 100 S. Ct. at 946.

F. The Commerce Clause Does Not Provide Independent Justification for Invalidating the Designation Statute.

As an alternative ground for invalidating the Designation Statute, the California Court of Appeal reached the startling conclusion, without citation of a single authority, that the Designation Statute contravenes "the express terms of the Commerce Clause . . . ." App. A at 12.

The Commerce Clause merely affords a measure of protection against state laws which unduly restrict the overall flow of interstate commerce. It does not preempt state regulatory schemes which merely alter the structure of the interstate market or which are prohibitive or burdensome with respect to particular interstate firms. *Exxon Corp. v. Governor of Maryland,* 437 U.S. 117, 126 (1978); *American Motor Sales Corp. v. Division of Motor Vehicles,* 592 F.2d 219, 223 (4th Cir.), *cert denied,* 444 U.S. 836 (1979). Moreover, in light of the well-established principle that the Twenty-first Amendment reserves to the States the power to regulate the importation and distribution of alcoholic beverages "unconfined by traditional Commerce Clause limitations" (*Joseph E. Seagram & Sons, Inc. v. Hostetter, supra,* 384 U.S. 35, 42 (1966), quoting *Hostetter v. Idlewild Bon Voyage Liquor Corp.,* 377 U.S. 324, 330 (1964)), challenges on Commerce Clause grounds to state laws analogous to Designation Statute were rejected in *Allstate Beer, Inc. v. Julius Wile Sons & Co., Inc.,* 479 F.Supp. 605, 610 (N.D. Ga. 1979), and *Dakota Wholesale Liquor, Inc. v. Minnesota,* 457 F.Supp. 480, 481-82 (D. Minn. 1978), *aff'd.,* 584 F.2d 847 (8th Cir. 1978) (Ruling on motion for preliminary injunction).

On the basis of the foregoing authorities, the ruling of the California Court of Appeal represents an unjustified

expansion of the Commerce Clause and places an undue restriction on the authority of the States to regulate liquor importation and distribution.

Conclusion.

For all of the foregoing reasons, petitioner urges that this Court grant the instant Petition.

Respectfully submitted,

JOSEPH A. BALL,
MICHAEL J. MALONEY,
JAMES POLISH,
Counsel of Record,
BALL, HUNT, HART, BROWN
and BAERWITZ,

WILLIAM T. CHIDLAW,
Counsel of Record,
Law Offices of
WILLIAM T. CHIDLAW,
A Professional Corporation,

Attorneys for Petitioner Wine & Spirits Wholesalers of California.